1812

1943

Economic Conditions
Governmental Finance
United States Securities

New York, July, 1943

General Business Conditions

THE domestic news of the past month has been to a deplorable extent a recital of confusion and controversy in the handling of food problems, in the price stabilization program, and in labor relations. Very considerable conflicts of opinion and interest are involved, and the difficulty of reconciling them is immense. One of the basic conflicts is between Congress and some of the executive agencies, arising from the opinion that the agencies are trespassing upon legislative powers and should be subject to closer legislative control. Another is between agencies themselves, arising from ill-defined lines of responsibility and overlapping authority, which is one of the gravest obstacles to unified and effective effort. A third is the fundamental conflict involved in trying to stimulate food production and maintain distribution on the one hand and keep prices down on the other; this causes a multitude of antagonisms, between the people and trades affected by "squeezes" and regulations and the agencies doing the regulating, between population groups, and between advocates of one plan or another for reconciling the two objectives.

All such conflicts generate feeling. Not everyone gives the situation the patient and reasoning study which it deserves, and the human tendency for men under pressure to rush in with poorly-informed statements, denunciations, impugning of motives and like actions is in evidence, adding to the confusion and helping little with the problems.

Problems of a Managed Economy

Even in the midst of war, it is appropriate to point out the basic lesson of these controversies. It is that any attempt to manage, through the decisions of an overhead authority, the complex economic activity of a country like the United States must inevitably expect to run into conflicts, confusion and resentments. The experience is demonstrating that it would be impracticable in normal times in a democracy to exercise the kind of detailed regulation of business and daily life that is now being tried; for the planners make mistakes, and if they were infinitely wise they could not be assured either of freedom from political and group pressures, or of whole-hearted cooperation from a people who cling tenaciously to their liberty of individual action.

What is now being determined, through trial and experience, is whether substitution of overhead regulation for the impersonal direction of the price system is practicable even in war; or whether the price system must be given more leeway, at least in some areas and to some limited extent, to keep the economic organization functioning at full speed and full efficiency, which is the crying need.

One certainty is that when the free price system is dropped some other effective method of guiding economic effort must be employed. Few of the current criticisms are directed against the principle of overhead control in wartime; but complaints as to its operation are countless. The resignation of Mr. Chester Davis as War Food Administrator, for example, has been interpreted over the country not only as the loss of an able man, in whom the public had confidence, from an important post; it is viewed also as an indication of the confusion and overlapping among government agencies having to do with food, and lack of power equivalent to responsibility, which may hamper Mr. Davis's successor as it hampered him and his predecessor.

Critics of the food organization have contended that its principal defect lay in giving power over prices to one agency and expecting another to manage production. Farm production is by millions of individuals. It is carried on under widely varying conditions. Experience is showing that its direction by an overhead authority without the assistance of price changes is a task of probably insurmountable complexity. On the other hand, there is a body of opinion which holds that price stabilization is paramount, and should be a separate responsibility.

Subsidy and Wage Policies

The argument over food subsidies comes to an end, at least temporarily, with the vote of

Congress overturning the subsidy program as it applies to the roll-back of beef, butter and coffee prices, and prohibiting future food subsidies without Congressional action.

This move is upsetting to Administration policy, and it leaves the next development uncertain. What will the wage policy be? A firm maintenance of the Little Steel formula was indicated by the War Labor Board in refusing to consider portal-to-portal pay for the coal miners, and in the action of Mr. Vinson, the new Economic Stabilization Director, holding up the proposed 8c an hour increase to non-operating railway employees. However, Mr. Philip Murray, President of the Congress of Industrial Organizations, has set July 15 as a deadline which will be followed by wage demands unless the cost of living by that time has been rolled back to the level of September 15, 1942, a clear impossibility. The War Labor Board has issued a statement which is pessimistic as to the possibility of maintaining the Little Steel formula if food costs continue to increase. But Mr. Murray and Mr. Green also have reiterated the "no strike" pledge, following the action of Congress in overriding the President's veto of the Connally-Smith anti-strike bill.

In light of these developments an early redefinition of stabilization policy, with respect both to wages and food prices, has become imperative. An equal need is to improve the organization which is directing the economic effort; for better management and administration, dealing with the causes of the maldistribution of food in light of the practical requirements of food distributors, and making forehanded decisions to relieve uncertainty, plainly would reduce the magnitude of the basic problem. The situation needs clarification and light, such as the report of the Baruch Committee provided in the rubber situation, both to establish an effective policy and to win for it public co-operation and support.

People are entitled to know, for example, why beef supplies are short and cattle slaughter subnormal, when cattle ranges are overstocked. If the reason is a good one, their co-operation with the food authorities would be better for knowledge of it; if it is not good, exposure would be a force for correcting the situation. There is still great wisdom in Woodrow Wilson's remark that "the highest and best form of efficiency is the spontaneous co-operation of a free people."

Improvement in Shipping

In contrast with the confusion in domestic affairs, the war news during the past month has created a general feeling of satisfaction and confidence. The outstanding developments have been the stepping-up in the bombing of the Axis countries and the considerable gains made against the U-boats, as reported by both American and British authorities. These gains should be extended as production of airplanes and escort vessels increases, and they may mark another turn of the war, comparable to the seizing of the initiative by the Russians and by the Allies in Africa, last November. Since that time submarine warfare has constituted the only offensive effort of the Germans; and if the turn has come the German people will not forget that in 1917-18 the defeat of the unrestricted submarine campaign signified the loss of the war.

The Allied peoples must guard against premature celebration, but they properly find encouragement in the shipping improvement. Not only are losses being reduced, crews and cargoes saved, and ship time used more effectively through the opening of the Mediterranean, but construction is adding steadily to the cargo fleet. In this country the authorities are confident that cargo ship construction this year will exceed 19 million tons, which is the latest of successively increased goals. This compares with an output last year of slightly over 8 million tons. Cargo ships are being launched at the rate of about five a day, and all previous world records of time consumed in construction as well as total output are being smashed.

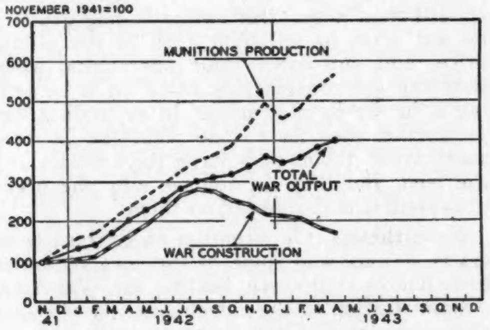
Shipping gains immensely strengthen the military effort. At the same time, they make it possible to bring into this country more of the imported commodities that are needed. Increases in imports have been evident for some time. Stockpiles of a number of commodities, including wool, lead, coffee and cork, have risen to a point where some relaxation of restrictions on their use has become possible. More shipping has been allocated to carry sugar, and fears of tighter restrictions on sugar consumption before the beet crops come in have abated. Imports of cocoa beans by the first of June had exceeded imports during the full year 1942; stocks have increased and indications are that more will be released for grinding. The Board of Economic Warfare has placed an order with the Indian jute mills for 700 million yards of burlap, additional to 150 million ordered earlier, and some months from now the arrival of this burlap may enable cotton textile mills now producing goods for the cotton bagging program to reconvert some of their looms back to their former use. Hopes for greater importations of vegetable oils, protein feeds and tropical fruits may be warranted.

The Production Prospect

These are significant developments, helpful to the civilian economy, easing the problems of the Washington agencies, and beneficial to the war effort. Other increases in civilian supply, especially to maintain necessary public

services, are being urged. Early in the month farm equipment manufacturers were authorized and promised materials to increase their production of implements for 1944 use to 80 per cent of the 1940 level, and sooner or later more railroad equipment will have to be built if the roads are to continue to perform the tremendous task of carrying the war traffic as smoothly and efficiently as they have done so far.

However, the instances where it is possible to increase civilian production must be considered the exception rather than the rule, confined to imports, to a few non-durable goods, and to the upkeep of absolutely necessary services. In durable goods supplies of most critical materials must still be devoted to the war effort, and the labor force is an overall limit on output. Also, more shipping calls for more war production. The supreme task is to move more weapons, men and supplies overseas, to make the coming offensives overwhelming. Much is made of the cancellations of ordnance and munitions contracts, which are running into huge totals; but the slowing down in some plants either is followed by quick changeover to other war work, or is offset by expansion elsewhere. The aggregate of war production is not declining, but the contrary.



Progress of War Production

The accompanying chart shows indexes of the progress of the war program as prepared by the War Production Board and published in Victory Bulletin issued by the Office of War Information. The top line covers all munitions and equipment production; the bottom line includes government-financed war construction; and the center line covers all goods and services, including construction, paid for by government funds. In the last month charted, which was April, total war output was four times, and munitions production was more than five and a half times, the pre-Pearl Harbor figure.

Livestock vs. Grain Production

Tightening feed supplies in recent weeks have put American farmers on notice that a shift of emphasis in food production, calling for more vegetable proteins and cereals instead of more livestock, has now become inevitable. Announcement of a detailed government program for that purpose is expected.

In the early part of the war effort the official policy was to step up production of livestock, dairy and poultry products. These were well adapted for lend-lease shipment, since they supplied high nutrient values in proportion to the cargo space used; and the program gave good reason for describing this as a "meat war," as distinguished from the 1914-18 "wheat war." The policy of stimulating production of these protective foods has been conspicuously successful. Aided at the start by large reserves of feedstuffs accumulated under the Government's loan programs, and supported by a fortunate succession of bumper feed crops, within three years hog production has been stepped up 50 per cent and cattle numbers have risen to all-time record levels.

For some time, however, far-sighted agricultural economists have been warning that at some point in this program our livestock numbers would begin to outstrip our feed-growing capacity. This point has now been reached. Furthermore, while recognizing that animal products are essential to a balanced protective diet, economists have emphasized that, from the standpoint of getting the most out of the land and the labor used in production, direct human consumption constitutes a much more efficient use of grains than animal consumption. This becomes of increasing concern as the food situation tightens.

Economists of the New York State College of Agriculture at Cornell University were among the first to advocate a shift in food production policy. The reasons for it were summarized by Professor W. I. Myers, head of the Department of Agricultural Economics, in a recent address, as follows:

> **Substituting direct consumption of crops for indirect consumption in the form of meat greatly increases the number of persons that can be maintained on a given quantity of crops. Animals are not efficient converters of grains and other concentrated feeds into human food, although products richer in certain critical nutrients may result. In converting 7 pounds of corn into 1 pound of pork about 84 per cent of the energy is lost. With other meats the proportionate loss in energy is greater In converting into livestock products the grain produced on United States farms in 1942, about 86 per cent of their caloric value was lost without considering the hay, roughage and pasture used as supplementary feed.**

A statement last February by F. A. Pearson and Don Paarlberg, also of Cornell, said:

> **If livestock production were decreased 10 per cent, the nation could feed 20 million additional mouths, and this could be continued year after year. Such a stretching of the food supply would be due to the consumption of cereals directly, rather than indirectly in the form of livestock products.**

One move to shift production from animal proteins to vegetable proteins was made by

Secretary of Agriculture Wickard early this year, when he asked for a substantial increase in capacity to produce soybean flour, for the purpose of shifting the end-consumption of soybeans from animals to humans. Normally, soybean cake, the protein by-product of oil extraction, has been fed to animals; but when processed into flour it is a valuable substitute for meat.

More Animals, Less Feed

The causes which have now made a shift in food production programs inevitable are the decline in supplies of livestock feed and the increase in the animal population. During the past crop year these trends have been pronounced, and they will continue during the crop year now beginning. On January 1, 1942 there were 75,200,000 cattle and 60,400,000 hogs in the United States. On January 1, 1943 the numbers were 78,200,000 and 73,700,000 respectively. On January 1, 1944, according to the best estimates now available, they will rise further to 82,500,000 and 80,000,000. This increase in numbers is after record-breaking slaughter.

Meanwhile grain stocks are being steadily absorbed. Carryovers of corn and wheat (which has now become an important animal food) into the new crop year will still be large. But only average crops of wheat and corn are expected this year, and the potential demand greatly exceeds the probable new production. The reversal in the wheat situation, through increased feeding and use for industrial alcohol, in one year will be phenomenal, — from a huge surplus to a tight supply.

The Iowa Farm Economist, published by Iowa State College, says that use of feed grains and wheat is at a rate 20 per cent above the expected crops. The Department of Agriculture's calculations show that an average of 28 or 29 bushels of feed grains has been used per animal unit during the past three seasons, but that the amount must drop during the feeding season beginning next October 1 to 25 bushels. Importation of Canadian wheat, oats and barley into the eastern dairy and poultry sections has begun and Australian wheat has been imported on the Pacific coast. Canada has a huge grain surplus, but transportation difficulties stand in the way of taking full advantage of it. Argentine corn supplies are short, even if shipping were available.

These figures clearly indicate that the upper limits of livestock production are about reached. An actual overall shortage of feed is of course still some time away. There are enough feed grains to last until the coming harvest, which will provide supplies for well into next year. But before the 1944 crops come in feeders will be scraping the bottom of the bins, unless their production policies are revised. It is a comment on the frailties of economic planning that restrictions on corn plantings, enforced under the agricultural adjustment program, were not removed until last January: while wheat restrictions were not taken off until February. The expansion in livestock numbers was under way, as official policy, long before.

Corn Held Off Markets

Meanwhile feed shortages in certain areas, away from the Corn Belt and in commercial positions, already present a problem. These shortages are due to uneven distribution. At the present profitable relation between hog prices and the ceiling price of corn, $1.06½ in Chicago, feeding of hogs in particular is stimulated. For this reason, and also because they are on notice as to the threatened shortage, Corn Belt farmers are holding and feeding their corn and the movement into the Eastern dairy and poultry sections and to the corn processing companies has been curtailed.

This uneven distribution is producing a sectional dispute between the Eastern dairymen and poultry raisers and the corn-hog farmers, as demonstrated by the speech of Governor Dewey of New York at the Governors' Conference in Columbus last month. Governor Dewey argued that dairy cattle from the standpoint of nutrition make a more effective use of feed than hogs. But naturally hog growers do not want to sell their corn at the ceiling price, and cut down their operations, when they can get considerably more for it by selling it in the form of pork. In expanding hog production they have done what the Government asked them, they have the animals and the feed, and they do not see why the brunt of curtailment should fall on them.

Nevertheless, the situation of Eastern feeders is serious, and some of the corn refineries have had to shut down, leading the War Food Administration to the extreme action of requisitioning corn in commercial stocks in order to keep the manufacture of starch and other essential products going. Such emergency measures may alleviate the situation temporarily, but a cure is needed. The ceiling on corn could be raised to make hog feeding less profitable, but this is interpreted as in conflict with the general stabilization program, for it might require raising the ceiling on other foods produced from the higher-priced corn. Also, a better distribution of corn could be restored by establishing ceilings to force down the price of hogs. But hog growers were guaranteed—as recently as April 10 this year—at least the present price of $13.75 (Chicago) until October 1, 1944, as an inducement to raise more hogs. Also, hog ceilings would create great practical administrative difficulties and would have to overcome strong political pressures. Suggestion of other measures, such as requi-

sitioning of corn on farms, evokes natural opposition and resentment.

The Need for Adjustment

Apart from the immediate problem, it is desirable that the adjustment of livestock production to the prospective reduction in the overall feed supply should begin early. Otherwise the feed shortage will be more severe when it comes; and liquidation of livestock then might be disorderly and disruptive, overtaxing slaughter capacity.

The need for adjustments raises major questions. How are they to be brought about? How rapidly should they proceed? What share should each of the livestock industries bear in the curtailment? The size of the corn crop, which cannot be accurately estimated for another two or three months, naturally is one of the important elements.

Under normal conditions adjustment of feed distribution and of livestock feeding policies is controlled by changes in the intricately related prices of feeds, animals and animal products. When the movement of corn to the Eastern dairymen or to the processors is inadequate the situation is corrected by higher bids for corn to attract it away from the hog raisers. When shorter feed supplies are in prospect, prices of feed move up relative to animals, inducing increased slaughter. These adjustments occur automatically.

Now, the guidance of automatic price changes is in effect suspended. To accomplish the adjustments either the Government must change the price relationships itself (as by substantially raising the price of corn) or it must decide by some other method who is to curtail feeding, and how much. Logically, the alternative to regulation through price changes is allocation of feed supplies by an overhead authority. This would be equivalent to rationing cattle, hogs and poultry—also the corn industries—just as people are being rationed. The problem need only be described in these terms to show its complexity and enormous difficulties. Rationing of people is for the purpose of dividing supplies evenly, but rationing of animals could not stop with that relatively simple objective. It would have to take account of the relative efficiency of each branch of the livestock industry as a producer of nutrients, and of the effects of the allocations on whole sections of the economy. The conflicts of interest and the resulting political pressures are easy to imagine.

Higher corn prices, on the other hand, although they would yield ground in the battle for stabilization, would accomplish the objective efficiently and effectively. Mr. Chester Davis, just before retiring as War Food Administrator, expressed his view as follows:

It is very important, to my way of thinking, that there be flexibility in feed prices, in order that live stock markets and feed adjust themselves readily. It is very difficult to do when you have a fixed ceiling on a feed commodity like corn.

It should be added that the money price of corn, which is largely fed on the farms where it is grown, has less direct effect on the cost of living than the price of almost any other major commodity.

Whatever the decision on corn prices, the War Food Administration doubtless will make every effort, through publicity, to persuade farmers to get the desired shifts in production under way early. If the country gives its whole-hearted cooperation to the campaign more difficult measures may be avoided. But the difficulties of persuasion are exemplified by the fact that hog farmers intend to raise 21 per cent more pigs this Fall than last, although the Government asked them not to increase more than 15 per cent. Had corn been higher or the hog price support lower, they would have been less eager to expand.

The 1944 Program

In broad outlines it is apparent what the 1944 food production program will be. It will call for increased production of wheat, corn and potatoes to supply the carbohydrates, and for still larger crops of soybeans, peanuts, dry beans and peas to supply the vegetable proteins. The livestock program will emphasize the need for maintaining and if possible increasing the production of milk, cheese and eggs at the expense of a leveling off, or decrease, in the production of butter, poultry meat, pork, beef and lamb. High finishing of cattle and lambs will be discouraged to conserve feedstuffs, as will the feeding of hogs to excessive weights. The objective will be to move livestock as directly as possible into slaughter from the ranges, with only a minimum of fattening in the feed lots. In order to encourage maximum meat production with a minimum use of grains, a schedule of desirable weights is to be established for livestock moving into slaughter channels.

Calling attention to the impending shortage of feeds in a message to the newly formed War Meat Board in Chicago just before his replacement by Judge Jones, Mr. Davis admitted also that drastic curtailment of feeding operations would be a serious menace to adequate beef production and marketing. He urged the Board to determine the exact point where feeding should stop, to assure the maximum production of beef without waste of grain.

Mr. Davis called on the cattle men not only to shorten the stay of cattle in the feed lots, but to start liquidation of the cattle surplus built up in recent years. He pointed out that this would increase the meat supply at a time when it is badly needed, ease the demand for feed grains, and place the industry in a stronger position to meet post-war adjust-

ments. The Texas and Southwestern Cattle Raisers Association has made a statement which is in harmony with Mr. Davis's views. The statement places the surplus of cattle at 15,400,000 head, which is the difference between cattle numbers January 1, 1939 and January 1, 1944. It points to the increased beef that would come from the slaughter of any substantial part of this surplus; and looking to the future Mr. Robert J. Kleberg, Jr., President of the Association, has commented that if the currently over-stocked cattle ranges should suffer a drouth or a post-war depression the nation's cattle men would be ruined.

International Significance of the Shift

Among other reasons for shifting away from livestock production, the common expectation that American food producers will be called upon for help to prevent starvation in Europe immediately after the war is entitled to consideration. Professor Myers, whom we have already quoted, made some comments on the need of preparation to meet European requirements in the speech referred to. He said:

> Any thought of feeding many additional millions of people on the diet to which we have been accustomed is utter folly. The 6 per cent of our annual production used for lend-lease in 1942 would feed about 8 or 9 million people on a diet similar to our own. The same amount of concentrated foods would supplement the diets of a somewhat larger number of people. However, all told, the United States produced enough crops last year so that if all had been fed directly to human beings, they would have provided the caloric requirements for a population about three and one-half times our own.
>
> If many additional millions are to be fed during the present emergency it must be largely on wheat, soybeans, dried beans and peas, corn and other crop products. Although such a ration is not as palatable nor as adequate nutritionally as one containing more livestock products it will prevent starvation and provide a maintenance diet until European food production can be re-established.

The question of relief as such was not before the United Nations Food Conference held in Hot Springs a month ago, but it could not be wholly left out of any discussion of the world food situation. The official summary of the results of the conference, prepared by the Secretary General, said:

> During this period (immediately after the liberation of occupied territories) the first call will be to reach freedom from hunger in areas devastated by the war. Until these lands themselves are able to produce and harvest, the most urgent demand will be for cereals and other foods which maintain human energy and satisfy hunger . . . It should not be too long before the production of the basic energy foods is sufficiently restored to provide for freedom from hunger. When that state is reached it will be necessary to increase wherever possible the emphasis on production of foods containing first class protein and other protective qualities necessary to good health.

In other words, the European countries must be influenced in their own food production programs by the same considerations which are now coming into effect in this country. The rebuilding of their depleted livestock herds will be secondary, in the immediate post-war period, to the alleviation of human hunger by production of the foods which can be produced most quickly, and use of all available land and labor for that purpose. Improvement of the diet through restoration to it of the desirable amounts of animal proteins is the longer term problem.

It is only reasonable to think that the Europeans who will be looking overseas for help in their food situation will find it more generously and gladly given if they themselves follow the policy outlined; and as practical people they may be expected to do so.

Money and Banking

The offering by the Treasury late last month of $2½ billions of 1½ per cent notes due September 1947 came at a time when Treasury war loan deposits in commercial banks were still in excess of $7 billions. The decision by the Treasury to re-enter the market so soon after the Second War Loan in April, and when funds on hand were still large, reflects the high rate of war expenditures which, together with the maturity of $325 millions of R.F.C. notes on July 15, has indicated a need for additional funds to tide over until the next war loan drive scheduled to commence September 9.

Action of the bond market has pointed to this as an opportune time for additional financing. Notwithstanding the heavy volume of Treasury securities offered in the December and April drives, there has been continuing evidence of a large unsatisfied demand. Prices of government securities have been firm throughout the list, with demand especially strong for partially tax-exempt issues.

Announcement of the new loan to come at the end of June brought an immediate reaction in the market, especially in the medium maturities, followed by a sharp rally as terms of the new issue were made public. Discovery that the offering, instead of making special provision for bank subscription as had been generally supposed, would be open to all buyers (with consequent certainty of scanty allotments) precipitated active bidding by banks and other investors for outstanding issues of desirable maturity, resulting in numerous new high prices.

The new issue was given a value by the market of over half a point premium, and a huge oversubscription was placed by banks and others. In fact, there was evidence of a large amount of speculative subscriptions by persons who were obviously buying only to make a turn and under the terms of the offering were awarded full allotment up to $100,000.

Commercial Banks and the Bond Market

During recent months the commercial banks have not only taken their full allotments of new issues but have been persistent buyers

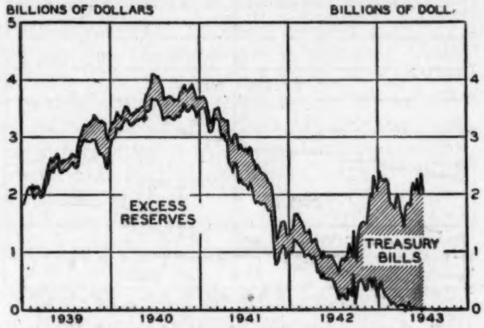
of government securities in the open market between the regular offerings. While holdings of certificates have increased largely at periods of new offerings, and those of bills have risen in step with the continued excess of weekly offerings over redemptions, the increase since the end of 1942 of $2.7 billions in bonds by the weekly reporting member banks has been a good deal more than was offered to these banks on subscriptions during the period. Moreover, this increase in bond holdings was made in the face of declining excess reserves. In fact, in New York City the volume of excess reserves has for several months stood at negligible totals.

This added absorption of Treasury bonds by the commercial banks may be accounted for in several ways. In the first place, improved earnings have made commercial banks more conscious of their tax position. During recent months savings banks and insurance companies, which pay little or no taxes on their holdings of federal securities, have been more or less steady sellers of the partially exempt issues for the purpose of switching funds into the higher-yielding (for them) taxable issues; and a substantial portion of these issues have been going into commercial bank portfolios.

Secondly, commercial loans in most sections have continued to decline, thus freeing funds for investment in government issues.

Thirdly, banks over the country are now showing a disposition to invest their excess reserves more fully. This, in turn, appears to be due partly to a growing acceptance of the present interest rate structure as likely to prevail at least for the duration of the war. The corollary of this is a belief on the part of many bankers that government bonds can be purchased without risk of loss. It is due partly also to a wider understanding of the advantages from an earnings standpoint of full investment and of reliance upon an adequate portfolio of bills and certificates for adjustment of reserve position. The educational campaign for fuller employment of bank reserves conducted by the Treasury and the Federal Reserve and the banking associations is evidently bearing fruit.

For some months now the situation at New York City has demonstrated the feasibility of operating on an extremely slender margin of excess reserves where banks hold substantial amounts of highly liquid short-term investments which can be quickly converted into cash at the Reserve Banks or by sale in the market. While it is true, as the accompanying diagram shows, that excess reserves in New York City have virtually disappeared, these figures have little meaning without consideration of the large secondary reserves in the form of Treasury bills. These to all intents and purposes are the equivalent of cash except that they bring in some earnings return.



Excess Reserves plus Holdings of Treasury Bills of Banks in New York City

Including these bill holdings, the New York banks have the equivalent of some $2 billions of excess reserves, or approximately half as much as at the peak reached in 1940. Adding their holdings of $2½ billions of certificates maturing within one year would lift the total of readily available funds substantially above excess reserves at their highest point.

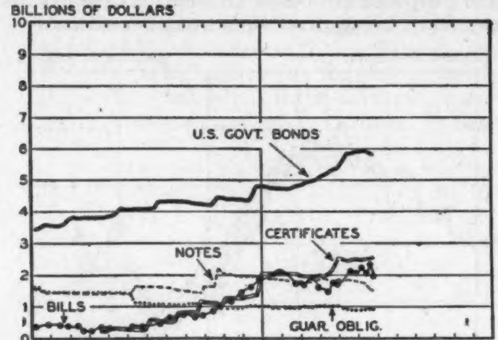
Trends In and Outside of New York City

Analysis of the changes in government security holdings by the commercial banks reveals that the expansion in total holdings over the past six months or more has been much greater for banks outside New York City than for those in the city. This is natural, in view of the location of excess cash reserves, now almost entirely in the interior.

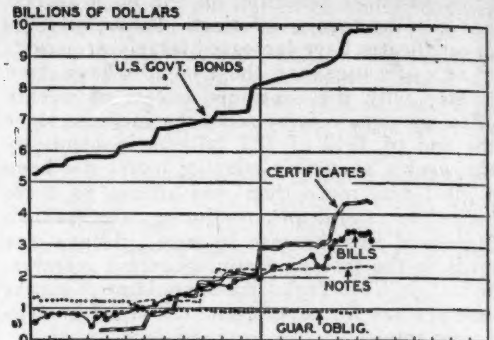
The buying of Treasury bonds (chiefly medium and longer-term issues) has been participated in by banks both in New York and outside as shown by charts on the next page. From December 30, 1942 to June 23, 1943 bond holdings of the New York reporting member banks increased nearly $1 billion, while the holdings of other weekly reporting member banks increased by $1.7 billions. With excess reserves largest relatively in the smaller cities and towns not all represented in the weekly reporting group, June 30 figures for all commercial banks, when available, should show a still greater absorption of Treasury bonds by the interior banks.

The increase in holdings of Treasury bills and certificates by the New York banks, while continuing, has been much more moderate than their increase in bonds. As these banks have from time to time run short of surplus funds they have preferred to dispose of their bills, while keeping and even adding to their holdings of bonds.

Banks in the interior, where excess reserves are more plentiful, have increased substantially their holdings of bills and certificates as well as bonds.



U. S. Government Security Holdings of Weekly Reporting Member Banks in New York City
(Latest date June 23)



U. S. Government Security Holdings of Weekly Reporting Member Banks Outside of New York City
(Latest date June 23)

The continuing demand for bonds has caused a major shift in the nature of Federal Reserve Bank holdings of government securities. The Reserve Banks have been feeding out their bonds in order to help meet the demands and prevent prices from rising too rapidly. At the same time they have been increasing their bill holdings. Since the end of 1942 Reserve Bank holdings of bonds have declined about $1¼ billion while their bill holdings have increased about $2½ billions and now comprise about half of their total government portfolio.

Relief to the New York Money Market

One important consequence of the increased purchase of government securities by interior banks has been to retard the tendency for funds to be continually drained out of the New York money market. For more than a year after the expanded national defense program was under way, the heavy subscriptions by New York banks to new Treasury issues, combined with large tax collections in this district, and the disbursement of Treasury funds on war plants, supplies, cantonments, etc., throughout the country were constantly siphoning funds to the interior cities and towns.

In the April war loan drive, stress was laid upon the need for selling a larger proportion of the new Treasury issues outside of New York City. The success of these efforts is shown by the fact that in overall subscriptions the New York Federal Reserve District took 38 per cent of the total, compared with 48 per cent in the December drive, and still higher in some of the earlier offerings. Of the commercial bank subscriptions, the New York district in April took 28.6 per cent of the total, compared with 36 per cent in December. Thus, more of the money is being raised in the sections in which it is being spent. In addition, the purchases by interior banks in the New York money market provide substantial remittances here and, together with an inflow of business funds, have served to offset in part the losses through Treasury operations.

The following table compares the principal factors in the gains and losses of funds in the New York district on a cumulative basis for the year 1942 and the first half of 1943:

Gains and Losses of Funds, Second Federal Reserve District. Cumulative Totals for Year 1942 and First Half Year 1943
(In Billions of Dollars)

	Year 1942	6 Months 1943
Treasury transactions	—2.3	—2.6
Other commercial and financial transactions	—1.8	+2.3
Gold and foreign account operations	+0.6	—0.2
Bankers' balances in N.Y.C.	—0.1	—0.1
Currency	—0.7	—0.3
Net total	—4.3	—0.9

It will be seen that the principal change this year as compared with 1942 has been the reversal of the net balance of "other commercial and financial transactions" which would include payments on security purchases made in this district for account of outsiders. This, along with the inflow of business deposits, have very largely offset the continuing loss on Treasury transactions.

Implications for Future Treasury Financing

The tendency of banks to invest their surplus reserves in bonds, and to meet temporary demands for reserves by fluctuations in their bill accounts, raises a number of questions concerning future rates and maturities of new Treasury issues. A continuing preference on the part of banks for the longer-term higher yielding issues would in the normal course tend to reduce the existing spread between yields on varying maturities by causing the long rates to ease and the short rates to rise. Such tendencies could be met in part of course by the issuance of more securities in the maturity ranges desired and letting up on the

issuance of bills now pegged at ⅜ths of one per cent.

Or, the Federal Reserve Banks could continue to absorb bills in substantial amounts. Their ability, however, to release bonds to the market, as they have been doing in recent months in order to hold down prices, is limited by their greatly reduced holdings of suitable issues.

Over the past year the Treasury has been rapidly increasing its short-term debt in the form of bills and certificates, the total of which has risen from approximately $3.5 billions to $26 billions. Last month the bill offering was increased from $900 millions to $1 billion weekly. The point that has now become clear is that the banks now consider these short-term obligations as the equivalent of cash and therefore feel free to invest heavily not only in additional short obligations, but in Treasury bonds, to a point in fact where there is danger that the whole structure of interest rates will be lowered. This is an undesirable development because it makes the new issues less desirable for individual investors, and it is money in the hands of individuals that must be reached in order to reduce inflationary tendencies. Under these circumstances a reconsideration of the amount of short-term issues placed in the market and the conditions under which these issues are absorbed by the Federal Reserve Banks appears desirable.

Foreign Balances in U. S. and London

The dollar balances accumulated in the United States by Latin American countries, and the sterling balances piled up by many countries in London, are now of such size that they are certain to be a major influence in international trade and exchange immediately after the war; and they are still growing. These balances originate in wartime trade shifts. Fundamentally, they reflect increased purchases by the United Nations from the countries of the Western Hemisphere and of the British Empire, particularly since the loss of the resources of Southeastern Asia. This trade has been far more one-sided than is normally the case. Because of concentration on war production and shortage of shipping, neither the United States nor Great Britain has been able to supply to these countries the goods which they want, and for which they are able to pay. The result is a heavy trade balance in their favor.

Latin America's Sources of Dollars

Since 1940 there has been a complete reversal in the balance of trade between the United States and Latin America. In that year our trade showed an excess of exports of $126 millions; in the year following, however, we had an excess of imports of $106 millions, and in 1942 our import balance came to almost $300 millions. Since our purchases are generally being maintained, there is likelihood of another huge import balance in 1943.

Nor are the favorable trade balances Latin America's only source of dollars. Large disbursements are being made by us in connection with Western Hemisphere defense, and we are financing a considerable amount of highway and factory building, expansion of mines, and cultivation of crops formerly obtained from Southeastern Asia. Still another source of dollars is the inflow of private capital into those countries.

As will be seen from the accompanying table, combined gold reserves and foreign currency resources of eleven Latin American countries aggregated about $1,325 millions at the end of 1942, compared with $775 millions in December 1940. Both gold and foreign exchange resources are apparently growing rapidly, for a tentative estimate put them at about $1,500 millions by the end of March 1943

Latin America: Gold and Foreign Exchange Reserves
(In Millions of Dollars)

	Dec., 1940	Dec., 1942	March, 1943	April, 1943
Argentina	430	658	710	762
Bolivia	7	20	....	....
Brazil	68	239	248*	....
Chile	35	56	60	....
Costa Rica	2	11	13	14
Colombia	25	62	75	....
Mexico	59	72	126†	....
Peru	20	29	30	....
Salvador	8	13	17	....
Uruguay	90	89	89	....
Venezuela	31	76	82	87
Total	775	1,325	....	....

* January 1943; † Gold only.

Note: Reported foreign exchange holdings were converted into dollars at current rates of exchange. Due to varying rates at which foreign currencies are actually acquired, this conversion can give only approximate totals.

Cuban gold holdings, for which figures are not regularly published, were put last Spring at about $30 millions.

Of the $1,325 millions of gold and foreign exchange resources at the end of December 1942, the gold reserves as separately reported by central banks and governments amounted to about $780 millions as against $645 millions at the end of 1940. Actually, however, gold reserves were considerably larger than this, since some countries do not separate gold held abroad from other foreign exchange reserves. Making allowance for gold so held, the gold reserves alone in December 1942 were probably in excess of a billion dollars.

In Argentina, which last December held almost half of all Latin American gold and foreign exchange resources, practically all but some $75 millions of blocked pounds was actually in gold. Sterling balances also figure in foreign exchange resources of other Latin

American countries, Brazil and Mexico in particular.

One of the largest increases took place in Brazilian gold and foreign exchange holdings. It reflects vast changes that are taking place in Brazilian economy under the impact of the war. Mexican gold and foreign exchange assets have likewise grown substantially, as a result of a large export surplus in 1942 and an inflow of capital estimated to have totalled some $100 millions over the past two and a half years. In an attempt to mop up the excess buying power and to check inflation, the Bank of Mexico last April lifted all curbs on the exchange of paper money for gold coins or bars.

The counterpart of the large accumulation of dollar exchange by foreign countries and its conversion into gold has been a decline in our own gold reserves and an increase in gold under earmark for foreign central banks and governments. At the end of June 1943, our gold reserves were about $400 millions below the peak of $22,793 millions reached in November 1941, while earmarked gold reached almost $3,000 millions by the end of last April, the largest amount ever held. In addition, foreign central banks and governments have acquired U. S. Government securities; holdings of these securities by the New York Federal Reserve Bank for foreign account stood at the end of 1942 at $481 millions. These figures are both in addition to the foreign deposits held at the Reserve Banks, currently $1,082 millions.

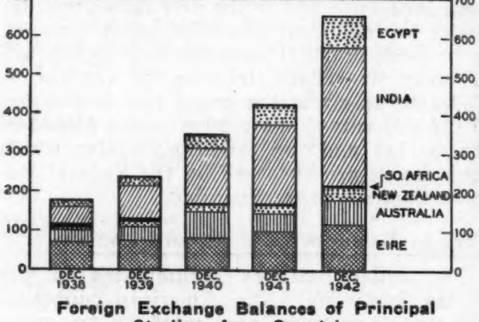
The Sterling Balances

While the countries acquiring dollar exchange can draw on the huge gold reserve of the United States, the holders of sterling balances are limited in securing gold or free exchange, unless, like the Union of South Africa, they themselves are important producers of newly mined gold. For practical purposes, excess sterling balances become blocked for the duration, until they can be paid for with British merchandise and services.

An early development in the war was the shift of Canada from the traditional position of debtor to Great Britain to that of creditor. Up to the end of March 1943 the deficit of the Empire on transactions with Canada came to about $3,300 millions (Canadian). This deficit was covered only in part by the shipment of gold ($250 millions), and by the repatriation of Government sterling debt and of some private debt, both of which came to about $840 millions. Thereupon the Dominion began to accumulate sterling balances; about $700 millions of these were eventually converted into an interest-free loan for the duration. Finally in 1942, to avoid the growth of an unmanageable debt, the Dominion made an outright gift of more than one billion dollars to the British Government. Another billion dollar gift to the United Nations was provided by Canada in the current budget.

Canada has stopped far short of pushing to the limit the repatriation of private British holdings of Canadian securities. The reluctance of the Dominion "to let its best customer get into our debt" as one of the members of the Parliament put it, has much to do with this policy.

London funds belonging to other sterling area countries have been expanding rapidly, although Great Britain has drawn deeply upon its investments and other resources to make payments to them. As the chart below shows, foreign exchange balances (mostly sterling) last December were almost four times as large as at the end of 1938. The data are based mostly on the currently reported reserves of various sterling area central banks and are by no means all-inclusive.



Foreign Exchange Balances of Principal Sterling Area Countries

The most striking accumulation of sterling balances has been in India. Despite the repatriation in about 3½ years of nearly all the Indian sterling debt of £360 millions ($1,450 millions), which was built up over some sixty years, the sterling security and foreign exchange holdings of the Reserve Bank of India last May exceeded £450 millions (over $1,800 millions). These huge balances originate in part in British expenditures for the defense of the country, which over the last three years were considerably greater than the total budgetary expenditures of the Indian Central Government, and in part from a favorable trade balance.

The problem now is what to do with these funds, which are likely to accumulate even faster when the campaign against Japan becomes more active. The British would like to see the funds used for the purchase of machinery and other industrial goods in Great Britain after the war. This solution is not liked, however, by Indian industrialists who fear the flooding of the Indian market by British goods to the exclusion of other countries. They demand that British commercial investments

also be repatriated. A suggestion has also been made of a rupee loan to Great Britain in order to mop up purchasing power as an anti-inflationary measure.

The Union of South Africa, whose export surpluses arise chiefly from the sale of newly mined gold, has maintained only small sterling assets in London. Earlier sterling accumulations were used to repatriate the entire Government sterling debt and more recently to repurchase gold mining and other South African investments held in Great Britain. More than 60 per cent of the outstanding gold mining shares is now said to be held in South Africa. As the international balance of payments improved it was no longer necessary to dispose of the bulk of the newly mined gold. Last December the gold stocks reached a temporary peak of about $635 millions as against $220 millions held at the time of the outbreak of the war. Considering only the white population of the Union, the per capita gold holdings are about twice as large as in this country.

Increase in Gold Holdings Outside of U. S.

Between 1934 and the end of 1940, the United States was absorbing not only the entire current output of gold but also large blocks of gold from the monetary reserves of other countries. Since 1940, however, our gold holdings have increased on balance by some $390 millions, which is but a fraction of the total world output of new gold. Even without guessing at the Russian output, and making liberal provision for industrial uses, world production must have aggregated at least $2,500 millions in this period.

Around $1½ billions of this new gold can be accounted for in the reported gold reserves outside of the United States. The Union of South Africa retained about $200 millions, while probably $600-700 millions went into reserves of Latin American countries. The European neutrals, particularly Sweden and Switzerland, have added in this period almost $600 millions to their reserves by converting their foreign exchange reserves into gold. These reserves were accumulated following the outbreak of the war and represented probably the proceeds of repatriated investments as well as refugee funds. The remainder of the newly mined gold went largely into unrecorded monetary reserves and government funds of various countries.

At the end of 1940, the known monetary gold reserves outside the United States were put by our Federal Reserve Board and the Bank for International Settlements at about $7,000 millions. In addition there were, according to the Bank for International Settlements, about $2,500 millions of gold in unrecorded holdings of exchange funds and government accounts outside of this country. Considering that about $2,000 millions of newly-mined gold must have been retained outside of the United States during the last two years or so, it follows that at the present time the known and unrecorded monetary reserves outside of this country must be in the neighborhood of $11,500 millions. This is roughly 34 per cent of the total monetary stocks in the world and almost as much in value as the world including the United States held at the end of 1932, prior to the dollar revaluation of the metal. Of course, the credit structure which the gold outside of the United States is supporting has become much vaster.

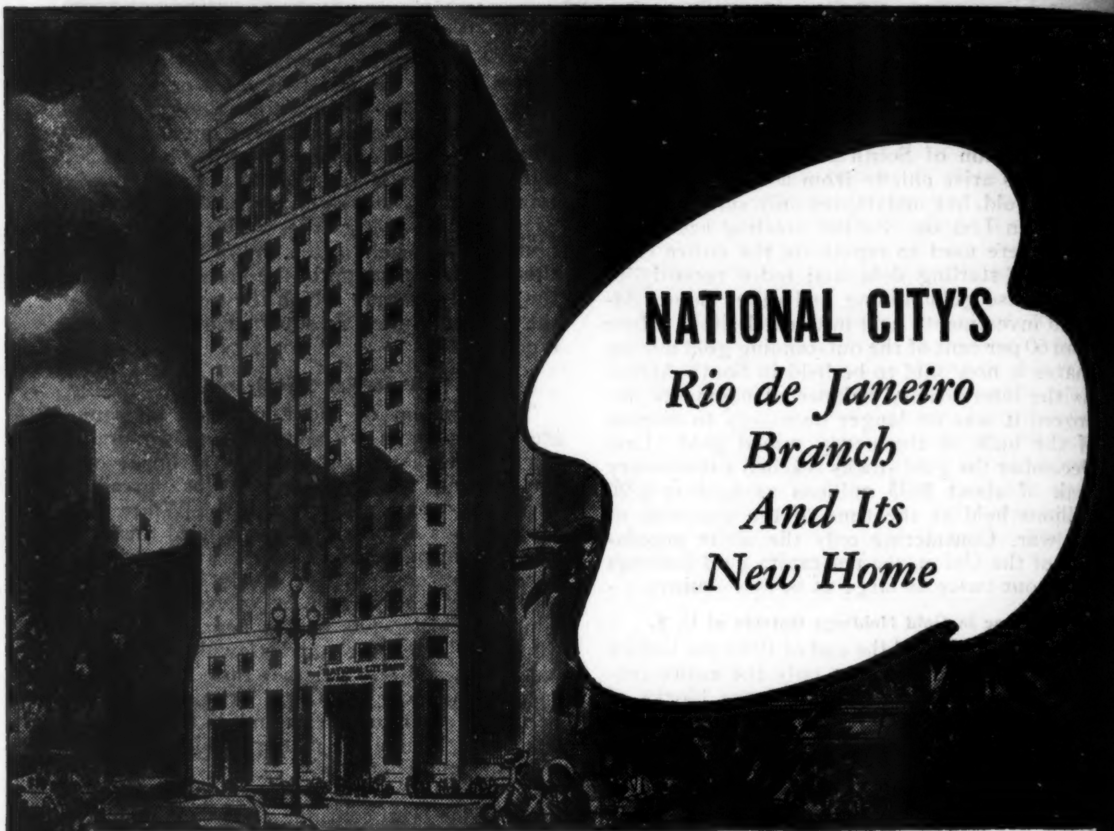
Post-War Significance

The problem of the liquidation of pound sterling balances without creating demoralizing currency instability will be a thorny one. By making recommendations for spreading their use over a long period, the White plan for currency stabilization recognized their importance in post-war relations. If other countries will accept British goods for them the problem of course can be solved effectively. Thus much depends on the degree of protectionism which the countries owning the sterling adopt, and also whether they will want to spend their money in Great Britain or to convert it to other currencies and do their buying elsewhere. These are matters which it is now difficult to predict.

Great Britain will need to expand her exports if she is to continue as the major buyer of the Empire's raw material and foodstuff surpluses. Her income from investments, which before the war amounted to about £200 millions, and which together with income from shipping and other invisible accounts contributed to the squaring of the import balance, will be greatly reduced by the war's heavy draft on her overseas resources. According to the latest White Paper, about £2,200 millions of external resources, gold, bank balances and investments were mobilized in the three year period 1940-42, and another £600 millions of foreign resources is to be conscripted during the present fiscal year.

From the point of view of post-war relations, the accumulation of gold and dollar balances on the part of Latin American countries is a favorable development. They will provide a cushion against the effects of post-war changes in balance of payments, and contribute to long term stability. One practical result, which already has come about, is a greater stability in currency values, accompanied by relaxation in exchange controls.

On the other hand, the expanded domestic purchasing power in the hands of the people of these countries, which the accumulation of gold and foreign exchange reflects, is having inflationary effects due to inability to import goods to absorb it. It is contributing to the upward spiraling of prices.



OFFICIALS of the Brazilian Government, the American Ambassador, and representative leaders in commerce and industry were present when National City recently opened its modern new home for the Branch which has served Inter-American business in Rio de Janeiro since 1915.

Here is re-affirmation of National City's own "good neighbor policy", which goes back 28 years, when the first overseas unit was established in Buenos Aires, the first such branch to be opened by any U. S. national bank. Now National City has 35 branches "South of the Border"; 10 have been in operation for more than 25 years. In Brazil alone the Bank has three other outposts, in addition to Rio de Janeiro.

The new home in Rio is the latest evidence of our belief that the future of Inter-American trade relations is soundly established.

THE NATIONAL CITY BANK OF NEW YORK

***Head Office:* 55 Wall Street**

INTER-AMERICAN BRANCHES

ARGENTINA
Buenos Aires
Flores *(Buenos Aires)*
Plaza Once *(Buenos Aires)*
Rosario

BRAZIL
Rio de Janeiro
Pernambuco
Santos
Sao Paulo

CANAL ZONE
Balboa
Cristobal

CHILE
Santiago
Valparaiso

COLOMBIA
Bogota
Barranquilla
Medellin

CUBA
Havana
Cuatro Caminos *(Havana)*
Galiano *(Havana)*
La Lonja *(Havana)*
Caibarien
Cardenas
Manzanillo
Matanzas
Santiago

MEXICO
Mexico City

PERU
Lima

PUERTO RICO
San Juan
Arecibo
Bayamon
Caguas
Mayaguez
Ponce

REPUBLIC OF PANAMA
Panama

URUGUAY
Montevideo

VENEZUELA
Caracas

Established 1812

Member Federal Deposit Insurance Corporation

PRINTED IN U.S.A.